INFORMATION LETTER

Not for Publication — NATIONAL CANNERS ASSOCIATION — For Members Only

No. 585 — Washington, D. C. — January 9, 1936

PROCESSING TAXES DECLARED UNCONSTITUTIONAL

In a sweeping 6 to 3 decision, the United States Supreme Court last Monday ruled in the *Hoosac Mills* case that the exaction of processing taxes was unconstitutional. This is the first decision dealing with the extent of and possible constitutional limitations on the Federal spending power under the General Welfare clause—a subject of vital importance to New Deal legislation. While the opinion has been fairly widely printed, the Association believes that members of the industry will be interested in an explanation by the Association's counsel of the Court's reasoning and in some indication of its breadth and bearing upon other Federal regulatory legislation in the agricultural field.

I. The Majority Opinion

Mr. Justice Roberts delivered the majority opinion of the Court. He quoted and reviewed various provisions of the Agricultural Adjustment Act, prior to its amendment on August 24, 1935, including those relating to marketing agreements and licenses and to the proclamation of reduction programs and the levying of processing taxes. He also outlined the history of the cotton processing tax and the circumstances under which the case before the Court arose. The Hoosac Mills, a Massachusetts company, was in receivership and the United States presented a claim for cotton processing and floor stock taxes. The receivers recommended that the claim be disallowed. The District Court ordered the taxes paid, and upon appeal the Circuit Court of Appeals reversed this order. The Government appealed the case to the Supreme Court.

1. *The right of the taxpayer to raise the question of constitutionality.* The Government contended that the receivers, as taxpayers, were without standing to raise the question of constitutionality because a previous Supreme Court case had held that a taxpayer could not enjoin the expenditure of Federal funds. This earlier case had proceeded on the theory that the taxpayer's interest in any expenditure, based upon the claim that his future taxes might be increased, was too remote. The Supreme Court rejected this argument on the ground, first, that this was not a suit to enjoin the expenditure of money but to resist the collection of a tax, and, secondly, that the processing taxes were not simply Federal excise taxes for the collection of revenue but were an inseparable part of a general scheme to regulate the production of agricultural commodities. It stated:

> "We conclude that the act is one regulating agricultural production; that the tax is a mere incident of such regulation and that the respondents have standing to challenge the legality of the exaction.
>
> "It does not follow that as the act is not an exertion of the taxing power and the exaction not a true tax, the statute is void or the exaction uncollectible."

2. *The validity of the processing taxes under the general welfare clause of the Constitution.* The Court then proceeded to consider whether the use of processing taxes for the payment of benefits for the reduction of agricultural production was authorized by Article I, Section 8 of the Constitution, which empowers Congress—

> "to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States. * * *"

This portion of the opinion is of utmost importance since it discusses for the first time the extent of the Federal taxing and spending power. The Court stated that:

> "It is not contended that this provision grants power to regulate agricultural production upon the theory that such legislation would promote the general welfare. The government concedes that the phrase 'to provide for the general welfare' qualifies the power 'to lay and collect taxes.' The view that the clause grants power to provide for the general welfare, independently of the taxing power, has never been authoritatively accepted."
>
> * * *
>
> "Nevertheless, the government assserts that warrant is found in this clause for the adoption of the Agricultural Adjustment Act. The argument is that Congress may appropriate and authorize the spending of monies for the 'general welfare'; that the phrase should be liberally construed to cover anything conducive to national welfare; that decision as to what will promote such welfare rests with Congress alone, and the courts may not review its determination; and finally that the appropriation under attack was in fact for the general welfare of the United States."

The Court then reviewed the historical development of the Constitution and discussed the constitutional commentaries dealing with the meaning of the "general welfare" clause. It concluded that the power to appropriate Federal monies was as broad as the power to levy taxes—including those for the general welfare. It adopted the doctrine first announced by Alexander Hamilton that the "general welfare" clause conferred a power separate and distinct from the other enumerated powers in the Constitution and that Congress therefore had a substantive power to tax and appropriate monies for the "general welfare" of the United States.

> "How great is the extent of that range, when the subject is the promotion of the general welfare of the United States, we need hardly remark. But, despite the breadth of the legislative discretion, our duty to hear and to render judgment remains. If the statute plainly violates the stated principle of the Constitution, we must so declare.

"We are not now required to ascertain the scope of the phrase 'general welfare of the United States' or to determine whether an appropriation in aid of agriculture falls within it. Wholly apart from that question another principle embedded in our Constitution prohibits the enforcement of the Agricultural Adjustment Act.

"The act invades the reserved rights of the states. It is a statutory plan to regulate and control agricultural production, a matter beyond the powers delegated to the federal government. The tax, the appropriation of the funds raised, and the direction for their disbursement, are but parts of the plan. They are but means to an unconstitutional end."

The Court then examined a number of previous decisions and concluded that:

"These decisions demonstrate that Congress could not, under the pretext of raising revenue, lay a tax on processors who refuse to pay a certain price for cotton and exempt those who agree so to do, with the purpose of benefiting producers."

3. *Since Congress could not tax to regulate agricultural production, it cannot use the proceeds from taxation to purchase compliance with Federal regulation.* The Court continued:

"If the taxing power may not be used as the instrument to enforce a regulation of matters of state concern with respect to which the Congress has no authority to interfere, may it, as in the present case, be employed to raise the money necessary to purchase a compliance which the Congress is powerless to command?

"The government asserts that whatever might be said against the validity of the plan, if compulsory, it is constitutionally sound because the end is accomplished by voluntary cooperation.

"There are two sufficient answers to the contention. The regulation is not in fact voluntary. The farmer, of course, may refuse to comply, but the price of such refusal is the loss of benefits. The amount offered is intended to be sufficient to exert pressure on him to agree to the proposed regulation."

The Court examined the A.A.A. method of reduction contracts and benefit payments and concluded that such method was not voluntary but amounted to "coercion by economic pressure."

It went on to rule, however, that even if the plan were truly voluntary, it would still be unconstitutional. It said:

"But if the plan were one for purely voluntary cooperation it would stand no better so far as federal power is concerned. At best it is a scheme for purchasing with federal funds submission to federal regulation of a subject reserved to the states.

"It is said that Congress has the undoubted right to appropriate money to executive officers for expenditure under contracts between the government and individuals; that much of the total expenditures is so made.

"Is a statute less objectionable which authorizes expenditure of federal monies to induce action in a field in which the United States has no power to intermeddle? The Congress cannot invade state jurisdiction to compel individual action; no more can it purchase such action."

The Court distinguished various types of Federal grants in aid such as those for education, health, etc., but insisted that:

"Congress has no power to enforce its commands on the farmer to the ends sought by the Agricultural Adjustment Act. It must follow that it may not indirectly accomplish those ends by taxing and spending to purchase compliance. The Constitution and the entire plan of our government negative any such use of the power to tax and to spend as the act undertakes to authorize.

"It does not help to declare that local conditions throughout the nation have created a situation of national concern; for this is but to say that whenever there is a widespread similarity of local conditions Congress may ignore constitutional limitations upon its own powers and usurp those reserved to the states. If, in lieu of compulsory regulation of subjects within the states' reserved jurisdiction, which is prohibited, the Congress could invoke the taxing and spending power as a means to accomplish the same end, Clause 1 of Section I would become the instrument for total subversion of the governmental powers reserved to the individual states.

"If the act before us is a proper exercise of the federal taxing power, evidently the regulation of all industry throughout the United States may be accomplished by similar exercises of the same power.

"It would be possible to exact money from one branch of an industry and pay it to another branch in every field of activity which lies within the province of the states.

"The mere threat of such a procedure might well induce the surrender of rights and the compliance with federal regulation as the price of continuance in business. A few instances will illustrate the thought.

"Let us suppose Congress should determine that the farmer, the miner or some other producer of raw materials is receiving too much for his products, with consequent depression of the processing industry and idleness of its employes. Though, by confession, there is no power vested in Congress to compel by statute a lowering of the prices of the raw material, the same result might be accomplished, if the questioned act be valid, by taxing the producer upon his output and appropriating the proceeds to the processors, either with or without conditions imposed as the consideration for payment of the subsidy.

"Should Congress ascertain that sugar refiners are not receiving a fair profit, and that this is detrimental to the entire industry, and in turn has its repercussions in trade and commerce generally, it might, in analogy to the present law, impose an excise of 2 cents a pound on every sale of the commodity and pass the funds collected to such refiners, and such only as will agree to maintain a certain price.

"Assume that too many shoes are being manufactured throughout the nation; that the market is saturated, the price depressed, the factories running half time, the em-

ployes suffering. Upon the principle of the statute in question Congress might authorize the Secretary of Commerce to enter into contracts with shoe manufacturers, providing that each shall reduce his output and that the United States will pay him a fixed sum proportioned to such reduction, the money to make the payments to be raised by a tax on all retail shoe dealers or their customers.

"Suppose that there are too many garment workers in the large cities; that this results in dislocation of the economic balance. Upon the principle contended for an excise might be laid on the manufacture of all garments manufactured and the proceeds paid to those manufacturers who agreed to remove their plants to cities having not more than a hundred thousand population. Thus, through the asserted power of taxation, the federal government, against the will of individual states, might completely redistribute the industrial population.

"A possible result of sustaining the claimed federal power would be that every business group which thought itself under-privileged might demand that a tax be laid on its vendors or vendees, the proceeds to be appropriated to the redress of its deficiency of income.

"These illustrations are given, not to suggest that any of the purposes mentioned are unworthy, but to demonstrate the scope of the principle for which the government contends; to test the principle by its applications; to point out that, by the exercise of the asserted power, Congress would, in effect, under the pretext of exercising the taxing power, in reality accomplish prohibited ends. It cannot be said that they envisage improbable legislation. The supposed cases are no more improbable than would the present act have been deemed a few years ago."

In conclusion the Court said:

> "It seems never to have occurred to them, or to those who have agreed with them, that the general welfare of the United States (which has aptly been termed 'an indestructible Union, composed of indestructible States'), might be served by obliterating the constituent members of the Union.
>
> "But to this fatal conclusion the doctrine contended for would inevitably lead. And its sole premise is that, though the makers of the Constitution, in erecting the federal government intended sedulously to limit and define its powers, so as to reserve to the states and the people sovereign power, to be wielded by the states and their citizens and not to be invaded by the United States, they nevertheless by a single clause gave power to the Congress to tear down the barriers, to invade the states' jurisdiction, and to become a parliament of the whole people, subject to no restrictions save such as are self-imposed.
>
> "The argument when seen in its true character and in the light of its inevitable results must be rejected.
>
> "Since, as we have pointed out, there was no power in the Congress to impose the contested exaction, it could not lawfully ratify or confirm what an executive officer had done in that regard. Consequently, the Act of 1935 does not affect the rights of the parties.
>
> "The judgment is affirmed."

II. The Minority Opinion

A minority opinion was written by Mr. Justice Stone, and Mr. Justice Brandeis and Mr. Justice Cardozo joined in this dissent. After pointing out that there was no question that Congress had the constitutional power to levy an excise tax upon the processing of agricultural products, and that the expenditure of public money in aid of the farmers was designed to "provide for * * * the general welfare," and that no question of improper delegation was involved, Mr. Justice Stone contended that the tax should not be treated as invalid merely because it was a step in a plan to regulate agricultural production and thus said to infringe on State power. He argued:

> "Here regulation, if any there be, is accomplished not by the tax but by the method by which its proceeds are expended, and would equally be accomplished by any like use of public funds, regardless of their source."

He reviewed the method of making benefit payments to farmers and denied that it amounted to economic coercion. He pointed out that if Congress had the power to appropriate money for the general welfare, it was a necessary incident of that power that it be able to determine the manner in which and purposes for which such funds should be expended.

> "The power of Congress to spend is inseparable from persuasion to action over which Congress has no legislative control."

After giving further examples of the use of Federal funds —for vocational rehabilitation to aid State reformation, State reforestation, and State forest fire prevention agencies, to support rural schools, and to aid in financing industry through the Reconstruction Finance Corporation—Mr. Justice Stone asked:

> "Do all its activities collapse because, in order to effect the permissible purpose, in myriad ways the money is paid out upon terms and conditions which influence action of the recipients within the states, which Congress cannot command? The answer would seem plain. If the expenditure is for a national public purpose, that purpose will not be thwarted because payment is on condition which will advance that purpose."

In the course of his dissent, he suggested that the majority's reason for imposing a limitation on federal spending—that such legislative spending power might be abused—"hardly rises to the dignity of argument. So may judicial power be abused."

In concluding his opinion that the use of monies collected by processing taxes for the making of benefit payments under a voluntary scheme was constitutional, the dissenting Justice said:

> "The power to tax and spend is not without constitutional restraints. One restriction is that the purpose must be truly national. Another is that it may not be used to coerce action left to state control. Another is the conscience and patriotism of Congress and the Executive.
>
> * * *
>
> "Courts are not the only agency of government that must be assumed to have capacity to govern. Congress

and the courts both unhappily may falter or be mistaken in the performance of their constitutional duty."

III. The Effect of the Decision

It has been noted that the *Hoosac* case deals with what may be termed the third great New Deal question—namely, the extent of and any constitutional limits on the taxing and spending powers of the Federal Government. The *Panama* case, commonly called the "Hot Oil case," dealt with the first great question—the extent to which Federal authority could be delegated to administrative officials. The *Schechter* case dealt with the area in which Congress can directly regulate activities in intrastate commerce which only indirectly affect interstate commerce. Neither the *Panama* case nor the *Schechter* case touched upon the question whether Congress could levy excise taxes and use the proceeds to purchase compliance with Federal desires. From this aspect, the *Hoosac* case may be deemed to be one of the most important decisions since the *Dred Scott* case.

It is obvious that a decision of such import cannot be hurriedly analyzed nor can its full implications and limitations be explored without careful study.

Of considerable interest to the canning industry, however, is the fact that the Government in this case, as in previous cases, argued that the party contesting the statute had no standing in court. It will be recalled that in connection with the proposals to amend the Agricultural Adjustment Act, the canning industry objected strongly to certain provisions which would have prevented canners from securing a court test of the validity of license provisions until a considerable period after the canning season. The importance of ready access to the courts for timely objection to unconstitutional action is perhaps indicated by the Court's rejection of the Government's contention that the taxpayer did not have a sufficient standing to question the constitutionality of the exaction. Otherwise the constitutionality of the Agricultural Adjustment Act could not have been determined, even at this late date, in the *Hoosac* case.

In addition, the *Hoosac* case, taken together with the *Panama* and *Schechter* cases, suggests the constitutional invalidity of other New Deal legislation.

1. Imposed licensing under the Agricultural Adjustment Act. In view of these three cases, a very strong argument can be made that the imposed licensing power sought by the A.A.A. in the Agricultural Adjustment amendments—and actually enacted as to two canning crops, asparagus and ripe olives—is beyond the constitutional power of the Federal Government in so far as such licenses seek to restrict production. As pointed out in the Association Bulletin of June 7, 1935, a distinction must be drawn in this connection between *intrastate production* and *interstate selling*.

2. The Bankhead Act. It is not unlikely that in view of these cases the Supreme Court will conclude that the Bankhead Act, providing for compulsory control of cotton production by the imposition of a large tax on excess production, is unconstitutional. Both the majority and minority opinions in the *Hoosac* case refer to the Bankhead Act as an example of compulsion, the majority stating that—

> "Congress has gone further and, in the Bankhead Cotton Act, used the taxing power in a more directly minatory fashion to compel submission."

Unless the Court should conclude that the Bankhead Act was not a method of controlling production but was more truly a revenue measure than the cotton processing taxes, it will undoubtedly declare the former Act unconstitutional. It is doubtful whether the Bankhead Act can be held to be truly a revenue measure.

3. The Potato Control Act. In general outline, the Potato Control Act, enacted as part of the Agricultural Adjustment amendments of August 24, 1935, follows the plan of the Bankhead Act and a decision on that statute will undoubtedly control the validity of the Potato Control Act.

4. The Kerr-Smith Tobacco Act. This statute, as amended last August, also follows the method of control by taxing excess production, originated in the Bankhead Act, and if subjected to judicial scrutiny will probably be held invalid.

Beyond these specific indications, it is not possible at this time to indicate the full range of effect of the *Hoosac* case. Whether the limitations on the refund of processing taxes, enacted last summer, to require processors to prove that they have not passed the tax on to the consumer, are consitutional, remains to be decided. Whether in the face of an unconstitutional taxing statute, the Federal courts are warranted in enjoining collection of taxes rather than in requiring the taxpayers to sue for refunds, likewise remains for decision in a case now pending before the Supreme Court. The bearing of the *Panama*, *Schechter*, and *Hoosac* cases on the validity of the Wagner Labor Relations Act and the Guffey Coal Act is dependent in large measure upon whether the facts in the particular cases presented disclose an activity in interstate or intrastate commerce. The constitutionality of the Guffey Act is also open to question on the grounds of improper delegation and the due process clause. Finally, the extent to which these three decisions will affect the operations of the Rural Resettlement Administration, the Public Works Administration, or the collection of taxes levied by the Federal Social Security Act, can be determined only after further careful study and possibly further decisions by the Court.

It seems appropriate in this report to suggest a word of caution in respect to federal legislation seeking to control the production and prices of agricultural commodities including canning crops. With the invalidation of the Agricultural Adjustment Act, there will undoubtedly be submitted to Congress a host of proposed substitute measures. Irrespective of the breadth of interpretation to be given to the *Hoosac* decision, some one or more of these may be enacted and enforced—at least until their constitutionality is finally determined by the courts. Completely to disregard such proposals on the theory that they are wholly unconstitutional may prove to be a dangerous policy: First, because a very considerable period of time may elapse between the enactment of a statute with its immediate enforcement and the determination by the Supreme Court of its constitutionality. Second, because constitutional law is dependent in the long run on what is decided in particular cases; and established Supreme Court precedents are frequently limited and occasionally reversed by exigencies of the times, changed circumstances, or changes in the personnel of the Court. As long as a substantial group of the electorate, their representatives in Congress, and the Administration are persuaded that agricultural legislation is necessary, proposals for further federal regulation will undoubtedly result in new legislation. The canning industry cannot afford entirely to disregard such proposals.